

No. 82-1226

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In the Supreme Court of the United States

ALEXANDER L. STEVAS.

OCTOBER TERM, 1982

FRANK J. LAIRD, PETITIONER

v.

INTERSTATE COMMERCE COMMISSION, ET AL.

**ON PETITION FOR A WRIT OF CERTIORARI TO  
THE UNITED STATES COURT OF APPEALS FOR  
THE THIRD CIRCUIT**

**BRIEF FOR THE FEDERAL RESPONDENTS  
IN OPPOSITION**

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### **QUESTIONS PRESENTED**

- 1. Whether the Interstate Commerce Commission abused its discretion in approving a reverse stock split by the respondent rail carrier that eliminated minority stockholders, on the ground that it was in furtherance of "a lawful object within the corporate purpose of the carrier" as required by 49 U.S.C. (Supp. V) 11301(d).**
- 2. Whether the Commission erred in conducting the proceeding under its "modified procedure," thereby limiting discovery and not affording an oral hearing.**

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## **BRIEF FOR THE FEDERAL RESPONDENTS IN OPPOSITION**

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### **OPINIONS BELOW**

The opinion of the court of appeals (Pet. App. A-10 to A-26) is reported at 691 F.2d 147. The decisions of the Interstate Commerce Commission on the stock issue (Pet. App. A-1 to A-9) and on the discovery request (Pet. App. A-40 to A-44) are not reported.

### **JURISDICTION**

The judgment of the court of appeals was entered on October 14, 1982. A petition for rehearing was denied on November 24, 1982. The petition for a writ of certiorari was filed on January 21, 1983. The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

**STATEMENT**

1. Under 49 U.S.C. (Supp. V) 11301(d), a rail carrier generally may issue securities only with the approval of the Interstate Commerce Commission.<sup>1</sup> Respondent Kansas City Southern Railway Company (KCSR), a Missouri corporation, sought Commission authorization to issue common and preferred stock to effect a reverse stock split. KCSR proposed to exchange one new share of preferred stock for each 7,000 shares of preferred stock outstanding and one new share of common stock for each 2,000 shares of common stock outstanding (Pet. App. A-12). The proposal also called for the purchase by KCSR of any fractional shares resulting from the reverse stock split. Based on a valuation study conducted by the investment banking firm of Kidder, Peabody & Co. (Kidder), KCSR proposed to pay \$30 per share for the preferred and \$210 per share for the common stock in purchasing these fractional shares (*ibid.*).<sup>2</sup> KCSR's parent corporation, Kansas City Southern Industries, Inc. (KCSI), owned 98% of KCSR's outstanding preferred stock and 99% of its common stock. Because of

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<sup>1</sup>Under 49 U.S.C. (Supp. V) 11301(d)(1), the Commission may approve an application to issue securities only when it finds that the issue:

- (A) is for a lawful object within the corporate purpose of the carrier and reasonably appropriate for that purpose;
- (B) is compatible with the public interest;
- (C) is appropriate for or consistent with the proper performance by the carrier of service to the public as a common carrier; and
- (D) will not impair the financial ability of the carrier to provide the service.

<sup>2</sup>Kidder used several standard valuation methods, including the capitalization of earnings method, to arrive at a value range of \$170-\$200 per share of common stock and \$18-\$22 per share of preferred stock. KCSR's board of directors authorized payment of prices above those levels (Pet. App. A-4 to A-5).

their limited holdings, none of the minority shareholders — 70 holders of preferred stock and 28 holders of common stock — would receive a full share of new stock under the split, and hence they would all be bought out by the transaction (*id.* at A-3, A-12). At a special shareholders meeting, only petitioner voted against the transaction (see J.A. 39a).<sup>3</sup>

In its application to the Commission, KCSR stated that the reverse stock split would allow it to eliminate unnecessary expenses associated with small minority stock interests. Specifically, it cited as one of the purposes of the transaction "the elimination of the expense of maintaining the capability of communicating with, reporting to, keeping records for, transferring stock of, tracing the whereabouts of, handling lost certificates of, employing a registrar for and otherwise continuing to maintain a stockholder support system" for the small number of minority shareholders (J.A. 71a). In addition, KCSR represented that simplification of the ownership of its equity securities would eliminate potential conflicts of interest between parent KCSI and minority shareholders of KCSR (J.A. 11a-12a, 73a-74a). KCSR also stated that the transaction would facilitate future acquisitions, mergers and other business ventures. Citing *Missouri Pac. R.R. Securities*, 347 I.C.C. 377, 409 (1973), KCSR argued that elimination of minority interests is a proper corporate objective, enabling a carrier to plan effectively a more efficient and economical transportation system (J.A. 72a).

Petitioner and another shareholder protested the application. The Commission set the proceedings for handling under its "modified procedure" (see Pet. App. A-1), which requires the parties to submit evidence in the form of written verified statements. 49 C.F.R. 1100.43. KCSR filed its

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<sup>3</sup>"J.A." refers to the joint appendix in the court of appeals.

verified statement on time. Ten days prior to the date specified by the Commission for the submission of petitioner's evidence, however, petitioner requested a modification of the Commission's procedural order in order to permit extensive discovery of KCSR and Kidder (see Pet. App. A-24 n.8) and to permit petitioner to file a supplemental and more detailed verified statement after discovery. Although Laird's request was untimely (*id.* at A-40), the Commission authorized discovery in several of the requested areas. Specifically, the Commission authorized the production of certain documents from Kidder, permitted interrogatories of R.S. Trenkman, Vice President of Kidder, and extended the time for filing petitioner's verified statement and KCSR's reply (*id.* at A-43).

2. After all the verified statements were filed, the Commission approved KCSR's application (Pet. App. A-1 to A-9). Finding that the record, made on the basis of written submissions, was "adequate and sufficient" to resolve the issues, the Commission denied petitioner's request for an oral hearing to cross-examine witnesses (*id.* at A-2). With respect to the merits, the agency determined that the proposed transaction met the requirements of 49 U.S.C. (Supp. V) 11301(d)(1)(A), in that the issuance of securities was "for a lawful object within the corporate purpose of the carrier and reasonably appropriate for that purpose" (Pet. App. A-6). Specifically, the Commission found that the elimination of the cost of maintaining a stockholders' support system was a lawful object whose benefit would inure to the carrier (*ibid.*). It also determined that the avoidance of a possible conflict of interest between KCSI and the minority stockholders was a proper corporate purpose (*ibid.*).

The Commission also determined that the proposed compensation for the holdings of the minority shareholders was adequate (Pet. App. A-6 to A-7). The Commission accepted as reliable Kidder's valuation methods (*id.* at A-7).

and rejected petitioner's claim for a higher value, stating that "[petitioner's] mere statements are insufficient for us to ignore the professional opinion submitted by applicant" (*ibid.*).<sup>4</sup> Finally, the Commission concluded that the transaction was permissible under Missouri corporate law (*id.* at A-8).

Petitioner sought a stay from the Commission, which was denied. Petitioner did not seek a stay from the court of appeals, and KCSR consummated the stock transaction on March 10, 1982. Petitioner is the only stockholder who did not accept cash in exchange for his shares.

3. The court of appeals affirmed (Pet. App. A-10 to A-26). The court held that there was substantial evidence to support the Commission's finding of proper corporate purpose (*id.* at A-16). The court rejected petitioner's contention that elimination of an unnecessary expense that effects only minimal corporate savings or avoidance of potential, as distinguished from actual, conflicts of interest cannot, as a matter of law, qualify as proper corporate purposes under 49 U.S.C. (Supp. V) 11301 (*ibid.*). Based on the Kidder report, the court also found substantial evidence to support the Commission's conclusion that the compensation offered for fractional shares was adequate (*id.* at A-16 to A-18).

With respect to petitioner's contention, based on Delaware and Pennsylvania corporate law, that a stock split designed to eliminate minority shareholders is illegal, the court stated that the Commission was bound to apply a

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<sup>4</sup>Petitioner asserted that, to arrive at the "real value" of the railroad, the appraiser should have determined either the value of KCSR as a going concern to an unspecified merger partner or the market and replacement values of KCSR's assets (J.A. 223a). The record reflects, however, that, shortly before receiving notice of KCSR's proposal, petitioner had purchased 20 shares of KCSR's common stock at a price of \$78 per share (J.A. 90a).

federal rule and therefore that the law of the state of incorporation (Missouri) was not necessarily controlling (Pet. App. A-18 to A-21). The court stated, however, that there is no general, comprehensive federal corporation law and no need for a uniform federal rule on this point (*id.* at A-21). Accordingly, the court held that the Commission acted properly in adopting as the federal rule a test that looks to the legality of the transaction under the law of the state of incorporation (*id.* at A-22). Because the Commission's conclusion that the transaction was legal under Missouri law was correct and unchallenged by petitioner, the court upheld the Commission's decision (*ibid.*). Finally, the court concluded that the Commission had acted within its discretion in limiting petitioner's discovery and denying him an oral hearing (*id.* at A-23 to A-26).

#### ARGUMENT

1. a. Petitioner's primary contention (Pet. 11-17) is that the court of appeals should have established a new federal rule of corporation law to be applied by the Commission nationwide in determining whether a railroad's proposed securities issuance "is for a lawful object within the corporate purpose of the carrier" under 49 U.S.C. (Supp. V) 11301(d)(1)(A). In particular, petitioner argues that the court of appeals should have adopted a rule that finds support in the law of two states and that has been recommended by some commentators, *viz.*, that elimination of minority shareholders can never be a lawful purpose. This contention is without merit.

The Commission's jurisdiction over the issuance of railroad securities is exclusive and plenary. *Schwabacher v. United States*, 334 U.S. 182 (1948). But, as the court of appeals explained (Pet. App. A-21), there is no general federal corporation law for the Commission to apply in reviewing transactions under 49 U.S.C. (Supp. V) 11301(d) (Pet. App. A-21). And, indeed, this Court has stated its

reluctance to establish uniform federal rules in corporate law areas traditionally subject to state regulation, such as the fiduciary duty owed by majority shareholders to minority shareholders involved here, because it would necessitate overriding the established policies of some states. See *Santa Fe Industries, Inc. v. Green*, 430 U.S. 462, 478-479 (1977). Thus, the court of appeals' approval of the Commission's reference to the law of Missouri, KCSR's state of incorporation, for testing the legality of the stock transaction is fully in accord with decisions of this Court and does not warrant further review.<sup>5</sup>

b. Petitioner asserts (Pet. 15) that this is the first case in which the Commission has permitted the elimination of minority interests without a showing that the corporation as a whole derived any "substantial" benefit as a result. But the Commission expressly found in this case that the elimination of the cost of maintaining a stockholder support system "is a benefit which will inure to the applicant and thus is a reasonable corporate purpose" and that the railroad would also benefit by avoiding possible conflicts of interest between the parent and minority stockholders (Pet. App. A-6). Petitioner's objection simply asks this Court to reweigh the evidence supporting the finding of a reasonable corporate purpose that has already been found sufficient by

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<sup>5</sup>The court of appeals correctly rejected petitioner's reliance (see Pet. 13-16) on two of its prior cases, *Dower v. Mosser Industries, Inc.*, 648 F.2d 183 (3d Cir. 1981), and *Coleman v. Taub*, 638 F.2d 628 (3d Cir. 1981) (Pet. App. A-19). These cases plainly are inapplicable here. *Dower* recognized that a cash buy-out of minority shareholders is permitted under Pennsylvania law and that such a transaction should not be enjoined absent some fundamental unfairness. 648 F.2d at 190. *Coleman* simply construed Delaware law, holding that it allows a cash buy-out of minority interests provided that it serves a corporate good, rather than simply the interests of majority shareholders, and the majority's fiduciary duty of fairness and good faith to the minority is satisfied. 638 F.2d at 634-635.

the Commission and the court of appeals; hence, it presents no issue warranting review by this Court. See *Universal Camera Corp. v. NLRB*, 340 U.S. 474, 490-491 (1951).<sup>6</sup>

2. Petitioner also contends (Pet. 18-19) that the Commission erred in denying further discovery and an oral hearing. This contention was correctly rejected by the court of appeals (Pet. App. A-23 to A-26).

Under the Commission's regulations, it is not required to hold an oral hearing unless material facts are in dispute and the verified statements do not provide an adequate basis for the resolution of the contested issues. These regulations have been upheld by the courts. See, e.g., *Crete Carrier Corp. v. United States*, 577 F.2d 49, 50 (8th Cir. 1978). Petitioner provides no basis for questioning the court of appeals' conclusion that the Commission's denial of an oral hearing was not an abuse of discretion (Pet. App. A-26). With respect to discovery, the Commission allowed petitioner more than required in permitting some discovery even though petitioner's request was untimely (*id.* at A-40). The Commission, however, judged the rejected portions of the request as unnecessary and refused to authorize a "fishing expedition" into the railroad's records (*id.* at A-42). The court of appeals correctly upheld this ruling, stating that "[t]he sheer volume of documents requested indicates more

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<sup>6</sup>Petitioner also belatedly asserts (Pet. 16-17) that, while Missouri law permits a "freeze-out" of minority shareholders, the procedure used here might not have been sanctioned by Missouri law, stating that "[a] Missouri court might well have concluded that \* \* \* the use of a reverse stock split, rather than a short [form] merger, to effect the cash-out was a fraud prohibited by Missouri law" (Pet. 17). The Commission, however, examined Missouri law here (an examination that the court of appeals recognized as "ably done" (Pet. App. A-22)), and it concluded that the transaction was lawful under Missouri law. There is no reason for this Court to reexamine that conclusion.

a person in search of an argument than one in search of support for an established position" (*id.* at A-24; footnote omitted).

#### **CONCLUSION**

**The petition for a writ of certiorari should be denied.**

Respectfully submitted.

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